LEADING THE WAY

Evolving Ontario's Electricity Market

INDEPENDENT ELECTRICITY MARKET OPERATOR 2002 ANNUAL REPORT

IMO Independent Electricity Market Operator

LETTER TO THE MINISTER OF ENERGY OF ONTARIO

I am pleased to submit the 2002 annual report of the Independent Electricity Market Operator (IMO) for the year ended December 31, 2002.

This past year has been one of tremendous achievement for the IMO – as well as one of change. This annual report highlights the role of the IMO in maintaining reliability throughout the province and developing the wholesale electricity market – now, and in the future.

Moving ahead, we look forward to continuing to work with your Ministry to ensure that the Province of Ontario continues to realize the benefits of a reliable, competitive wholesale market.

James C. Baillie
Chairman
March 31, 2003

2002 ACHIEVEMENTS

• The IMO successfully launched the wholesale electricity market on May 1, 2002, the culmination of extensive testing, training and dry runs. The market almost immediately began to deliver the benefits of competition – greater price responsiveness by large volume users, increased access to imports and enhanced reliability.

• As Ontario experienced one of the hottest and longest summers on record, the IMO maintained system reliability with no interruptions in service. Ontario established a new peak demand record on August 13 of 25,414 MW, while consumption in six of the first eight months of market operations set all-time monthly records.

• The IMO continued to be a North American leader in reliable power system operation. An audit by the North American Electric Reliability Council commended our highly-trained staff and good utility practices, citing the IMO as a model for other system operators. An annual peer review by our counterpart market operators in the Northeast U.S. also showed that we exceeded expectations during a period of unprecedented change and challenge in the Ontario electricity industry.

• Through our Help Centre, we responded to an average of 700 enquiries each week from market participants and interested stakeholders. We also launched a comprehensive consultation process to provide market participants with an effective voice in the evolution of the market, particularly on commercial and reliability issues affecting them.

• With market launch, all the tools and systems that provide market participants and the public with up-to-the-minute information about prices, demand and system status kicked into gear. The IMO Web site experienced more than a million hits each month as users logged on to track market activity. From market opening to the year's end, almost 100,000 settlement statements were successfully issued to market participants.

The IMO's customers are generators who produce electricity, transmitters who send it across the province, retailers who buy and sell it, industries and businesses that use it in large quantities, and local distribution companies that deliver it to residential customers. Each of these 243 market participants has a specific role to play in the market, and each looks to the IMO – as the hub – to direct the flow of electricity across the transmission system and operate the wholesale electricity market effectively.

> MARKET FACTS

• The IMO is responsible for the safe and reliable operation of Ontario's bulk electrical system – one of the largest and most diverse markets in North America. On a minute-to-minute basis, we forecast the energy needs of the province's industries and businesses, as well as its 12 million residents.

• By December 2002, there were 243 organizations participating in the market:

21 Generators
4 Transmitters*
93 Distributors*
37 Wholesale sellers/Retailers
90 Wholesale consumers/End-use customers

• During the first eight months of the competitive market, Ontarians consumed 103 TWh of electricity, resulting in the IMO handling $7.4 billion in commodity sales and service fees.

• Each day, the IMO issues roughly 34,000 dispatch instructions to suppliers, generating 4,000 different electricity prices – all resulting in 400 settlement statements for market participants.

• Within Ontario, there are 28,900 kilometres of transmission lines. The province also benefits from 4,000 MW of interconnections with Manitoba, Quebec, New York, Michigan and Minnesota.

• In December 2002, Ontario's total installed generation capacity was 30,548 MW. This capacity included:

4 nuclear stations (10,836 MW)
59 hydroelectric stations (7,615 MW)
5 coal-fired stations (7,546 MW)
24 oil/natural gas stations (4,485 MW)
2 miscellaneous – wood waste (66 MW)

*Two transmitters also act as distributors

104-05015/

THE IMO IS LEADING THE WAY IN EVOLVING ONTARIO'S ELECTRICITY MARKET FOR THE BENEFIT OF ALL CUSTOMERS. OUR JOB IS TO MEET ONTARIO'S POWER NEEDS BY OPERATING A COMPETITIVE WHOLESALE ELECTRICITY MARKET THAT ENHANCES RELIABILITY AND PROMOTES FURTHER DEVELOPMENT OF THE ELECTRICITY SECTOR.

INDEPENDENT ELECTRICITY MARKET OPERATOR

2002 ANNUAL REPORT

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RESTRUCTURING

WITH THE OPENING OF THE WHOLESALE MARKET, THE IMO HELPED TO BREAK NEW GROUND IN MANAGING THE FLOW OF ELECTRICITY IN A MORE TRANSPARENT AND CONSULTATIVE MANNER. THE RESULT WAS A MORE RELIABLE, RESPONSIVE SYSTEM AT A TIME WHEN SUPPLY CONDITIONS WERE EXTREMELY TIGHT. – James C. Baillie

TAKES A MAJOR STEP FORWARD

The restructuring of the Ontario electricity marketplace took a major step forward in 2002 with the opening of the wholesale market on May 1. The market almost immediately demonstrated its value through the record heat of the summer months when market conditions played a major role in maintaining the reliability of the Ontario electricity system under extreme demands never before encountered.

With the opening of the wholesale market, the IMO helped to break new ground in managing the flow of electricity in a more transparent and consultative manner. The result was a more reliable, responsive system at a time when supply conditions were extremely tight.

The IMO has received invaluable assistance from outside expertise to guide us through the opening of the market and the challenging early times. We are fortunate to have a strong Board of Directors composed of independent and stakeholder members to represent the interests of all stakeholders and provide independent stewardship for the operation of the market. I am appreciative of the expertise and efforts of all Directors and their commitment to a competitive wholesale electricity market.

The Board – and the market – have been well served by the various panels formed to address efficiency and competitiveness issues. The Technical Panel has provided insight into the workings of a successful market, facilitating changes to market rules that have increased its overall effectiveness.

We have also received valuable advice and counsel in the early stages of the market from the members of the Market Surveillance Panel. The Panel's first report pinpointed areas for improvement that need to be addressed, thus providing valuable insight on the necessary path ahead. We look forward to their continued contribution.

Finally, I wish to thank all employees at the IMO who continually demonstrate their expertise and dedication to the operation, regulation and evolution of the wholesale electricity market. I am proud to be associated with such dedicated and skilled employees. From the operators in the control room keeping the lights on in Ontario to the settlements staff processing almost 100,000 statements since market opening, our employees exemplify why the IMO is held in such high regard by market participants.

The provincial government decision to fix the commodity cost for low-volume and other designated customers places Ontario in a situation similar to other jurisdictions where the market was introduced in successive stages, beginning with the wholesale customers. Ontario remains at the vanguard of progressive energy markets in North America. We remain convinced that by following good policies in a consistent way, the government can help to develop an environment that will ultimately give all Ontario residents the benefits of a truly competitive market.

James C. Baillie
Chairman
March 31, 2003

FUTURE RELIABILITY REMAINS PARAMOUNT WITH THE IMO, AND OUR EMPLOYEES CONTINUE TO ASSESS THE SECURITY AND ADEQUACY OF ONTARIO'S ELECTRICITY SYSTEM IN OUR 18-MONTH AND 10-YEAR OUTLOOKS. – Dave Goulding

A COMPETITIVE MARKETPLACE

The opening of the Ontario electricity market on May 1, 2002 marked the successful culmination of years of planning and months of work by the Independent Electricity Market Operator and others involved in restructuring the electricity marketplace.

Our employees worked diligently with stakeholders to design, develop and test the rules, processes and systems for the wholesale market prior to its opening. We also worked closely with more than 200 market participants on education and training programs to help them quickly realize the benefits of a competitive marketplace.

A successful dry run with all market participants in the month preceding market opening demonstrated that we were ready on all fronts. Indeed, the numerous systems and processes put in place to run the market and operate the power system have proven to be extremely robust, exceeding reasonable expectations.

Throughout the rest of the year, our employees remained committed to the fair and competitive operation of the market while directing the flow of electricity across Ontario's transmission grid to every corner of the province.

During the tight supply times of the summer, IMO staff, suppliers and transmitters experienced some challenging days in maintaining a reliable electricity system. But we kept the lights on, thanks in part to large wholesale customers who reduced demand by shifting their operations and load to off-peak hours in response to higher prices. At a time when Ontario supplies were lower than expected, the market was also able to attract generation from outside Ontario at record levels to help meet demand at home.

Future reliability remains paramount for the IMO, and our employees continue to assess the security and adequacy of Ontario's electricity system in our 18-month and 10-year outlooks.

The year was a challenging one for the IMO in other ways as well. Our staff responded quickly to market changes, including the provincial government's decision to establish a fixed commodity price for low-volume and other designated customers. We processed funds for the $75 rebate payment to ensure that Local Distribution Companies were able to provide the payments to their customers before Christmas. The provincial government's recent commitment to the wholesale market will mean further but welcome challenges for us as we move forward.

Ontario has already made great progress in developing the wholesale market. That progress can and will continue. As you will see in this report, we are embarking on the next phase in the development of the market with mechanisms for greater price stability and transparency.

Through the efforts of our employees, market participants and stakeholders, I believe the market can continue to deliver benefits to every Ontario electricity customer.

DAVE GOULDING
President and Chief Executive Officer
March 31, 2003

LEADING THE WAY

RELIA

PAUL MURPHY
Chief Operating Officer – Market Operations and Forecasts

HOW IS A RELIABLE SUPPLY OF ELECTRICITY MAINTAINED?

> INDEPENDENT ELECTRICITY **MARKET OPERATOR**

Reliability is no accident. At the IMO it begins with accurate forecasting and assessment of power system capability and continues with skilled system operators who monitor, anticipate and respond to events on the power system as they unfold. Reliability is maintained through a healthy competitive market that attracts needed power to the system and provides customers with the information they need to move their times of use, or load, to periods where demand and price have dropped.

The IMO is the nerve centre that keeps Ontario's electricity flowing – it's a responsibility that we take seriously and meet at the highest levels, 365 days a year. The starting point in maintaining reliability is our short- and long-term system outlooks. These outlooks provide the market with clear planning signals on system requirements and opportunities to either provide generation or plan on reducing demand. They also provide important signals to generators and transmitters about when to request IMO approval of their planned maintenance work.

The IMO also provides daily forecasts, which are updated on a regular basis. These forecasts are a crucial tool in running an efficient, reliable market. The market's response to these signals is essential to "keeping the lights on."

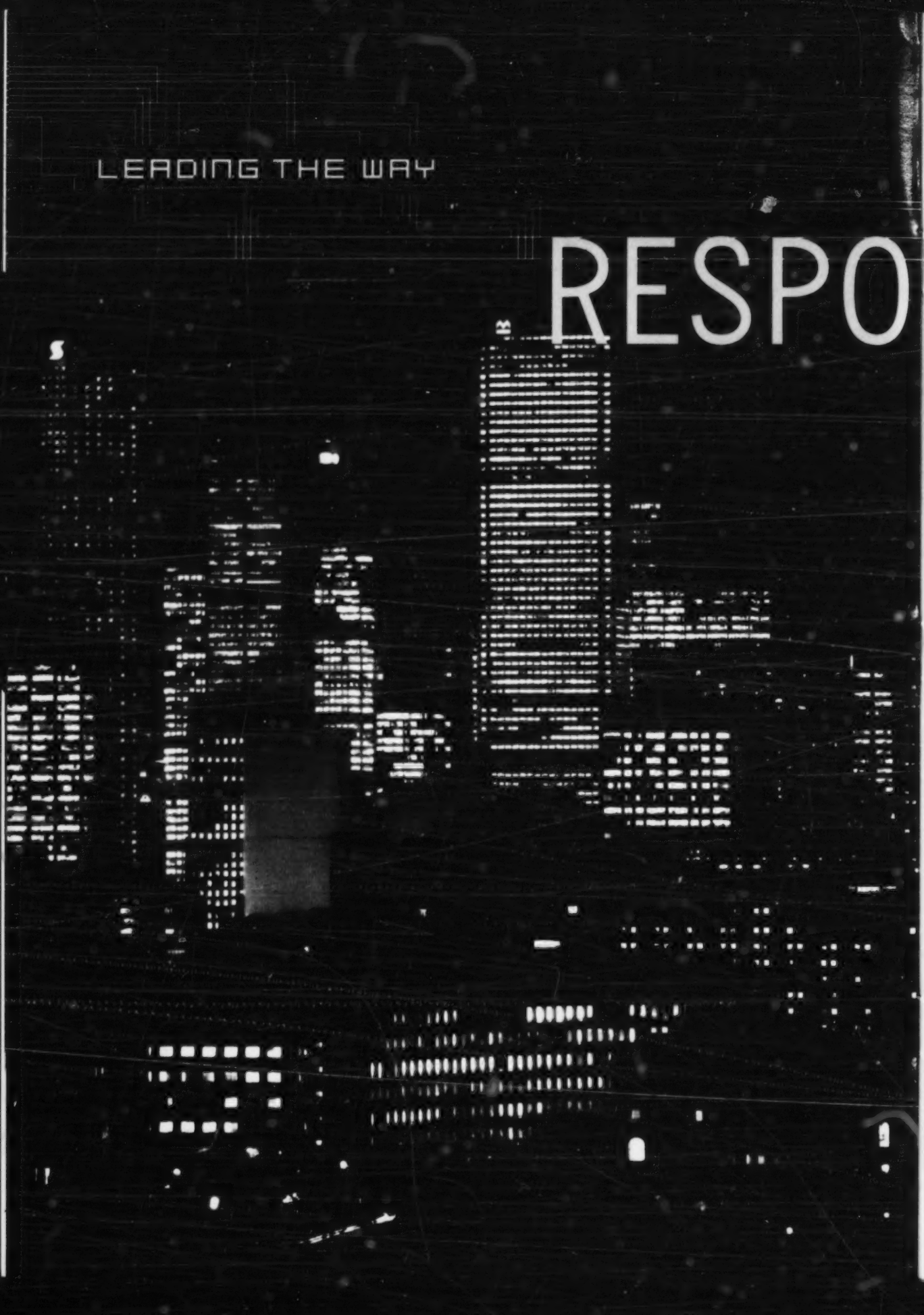
This was never so evident as in the summer of 2002, when sustained record temperatures put a tremendous strain on the power system and created record demands for electricity. At the same time, reduced capability at some generating stations and a lack of rain combined to create a shortfall in available generation. Despite these challenges, Ontario homes and businesses had the power they needed. The lights stayed on due to many factors, including good daily management by the IMO, a market that attracted huge volumes of imported power, and the reduction in demand from large users responding to higher prices.

One of the IMO's biggest challenges will be to create the market mechanisms necessary to attract new supply to the province. More suppliers bring enhanced reliability and more flexibility and stability to the system. We will work closely with the electricity industry so the people of Ontario can continue to enjoy a reliable supply of electricity at a competitive price.

Hydro One Transmission Lines

LEADING THE WAY

RESPO



DARREN FINKBEINER
Manager – Design Authority

HOW ARE ENERGY PRICES ARRIVED AT?

Price and product reliability are crucial in an electricity marketplace. Purchasers need to know they are getting a reliable supply of electricity at a fair price, while generators need to be confident the market allows them to recover their costs and make a reasonable return on their investments.

The Ontario electricity market was restructured after a comprehensive consultation process with market participants and other stakeholders. The IMO also studied and adapted the best practices followed in other electricity markets. The result was a wholesale electricity market that has had remarkably few growing pains, and resulted in an average price in 2002 of 5.6 cents per kilowatt-hour. This energy, or commodity, charge accounts for roughly half of a typical electricity bill.

Each day, the IMO predicts the consumption, or load, for the province, and this figure is updated regularly. Generators then offer their best price to supply that load. The market calls upon the least expensive set of bids and offers to meet the immediate needs of all power consumers. The IMO uses a Market Clearing Price, which means all generators are paid the same as the highest offer used in each hour. If suppliers' bids are too high, they run the risk of their offers not being used. This system, which is used in other jurisdictions, encourages generators to offer in at their cost to operate, rather than trying to anticipate what the price might be and offering at that higher price.

The wholesale market is transparent, allowing customers to see prices fluctuate based on such things as the season, time of day, demand and supply. Customers can shift consumption away from the peaks, or high points of daily demand, to times when prices are typically less expensive. In the future, as interval meters become more common, residential and other small users will be able to change their usage patterns to their advantage.

The IMO also encourages and accepts offers for imported power. This promotes lower prices by providing more competition, and also supports greater reliability. There were many times in 2002 when imported power played a major supply role when internal generators could not meet the domestic demand.

As the market develops, the market rules will evolve to match new experiences and situations, but the goal will always be the same: a reliable supply of power at a competitive price.

Toronto at Night

LEADING THE WAY

CUSTOMER

RAYHAN MALIK
Market Relations Consultant – IMO Help Centre

HOW DOES THE IMO SERVE ITS CUSTOMERS?

Preparing the market for launch was an enormous co-ordination effort that required strong market participant relationships. Working together was the key to achieving a smooth transition to live market operations on May 1, 2002, and it will be the key to further enhancing the market.

Our focus on relationship building starts with the IMO Help Centre – the gateway for market participants to get information quickly and communicate with the entire organization. Each market participant works with an assigned Help Centre representative to clarify information and resolve outstanding problems. This customer service orientation extends to championing customers' needs. Issues of common concern are pursued by the Help Centre and form a basis for further improvements to the market.

The work of the Help Centre is augmented by other Client Support programs such as market participant training, market information services, and proactive e-mail updates that strengthen market participants' ability to achieve the benefits of competition. By adopting a customer-focused approach throughout the organization, the IMO ensures that all programs and services are developed and delivered with the customer in mind.

In 2002, the IMO reinforced our commitment to customer service by launching a consultation process that touches on almost every aspect of the market. These consultations provide the foundation for the IMO's decision-making process, ensuring that our vision, policies and practices are realistic, fair and reflective of the aspirations of the market.

The Market Advisory Council is the central forum for these consultations. Co-chaired by the Vice President, Market Services, and a representative elected by members, the Council meets regularly throughout the year to discuss key issues facing the market – from the implementation of the provisions of Bill 210 to the Market Evolution Program.

The IMO believes discussions that could affect all market participants – and, ultimately all Ontarians – should be open, transparent and inclusive. Market participants and other interested stakeholders are, for example, encouraged to suggest improvements to the market rules, which are then reviewed by a panel of peers and published on our Web site for broader comment.

The IMO's approach to developing and enhancing Ontario's electricity market is rooted in deepening our relationships with market participants. As experience with the market builds, the benefits of these relationships will grow.

Image of Electricity Arc Furnace provided by Ivaco Rolling Mills.

IMO
Today's Market

BILL LIMBRICK
Vice President – Information Technology and Infrastructure

WHAT CAPABILITIES ARE NEEDED TO RUN THE MARKET?

Leading-edge technology, technical know-how and a wealth of experience. This is the IMO.

Operating the market is an ongoing and highly complex process requiring the close co-ordination of many functions within the IMO. We forecast electricity demand and then, using market mechanisms to balance the real-time needs with supply, we dispatch orders and determine prices. Our responsibilities range from the continuous tracking of energy flows at points along the transmission system to the preparation of settlement statements and invoices for electricity that has been bought and sold. We carry out these responsibilities with little margin for error in terms of accuracy and timing.

These tasks are performed by approximately 400 dedicated IMO employees, who ensure that their actions converge and result in the smooth functioning of the market. This is a diverse group of people, representing a broad range of skills, including system control operators, meteorologists, market relations consultants, financial analysts and IT systems specialists. These individuals are the reason the IMO is credited by our peers with running "a first-class operation."

The work of IMO staff is supported by a sophisticated arrangement of information technology, networks, applications and databases that gather, process, send and store thousands of pieces of information. These systems connect generators, energy consumers and electricity meters across the province and beyond. With 24-hour on-site support and several layers of back-up, these systems are designed with high reliability in mind.

The IMO's collective skills and expertise were put to the test in the months leading up to market opening, as we readied systems and procedures for the launch. Our training and communications programs supported market participants in readying their own operations. Extensive dry runs ensured that all the components of the market performed as they should. The many months of hard work and late nights paid off with a successful market launch on May 1, and a seamless transition to live operations.

As the needs of the market and market participants evolve, IMO staff will make sure that our systems and processes support this ongoing evolution. Changes will be implemented so that our procedures, processes and systems work in step with each other and with those of market participants – all with the ultimate goal of better serving our customers.

Photo taken at Northland Power Inc.

LEADING THE WAY
INTE

PAULA LUKAN
Assistant Analyst – Market Assessment and Compliance Division

WHO PROTECTS THE INTEGRITY OF THE MARKET?

The cornerstone of competition in any open market is the understanding and assurance that the rules governing the market are fair and that any breaches of these rules will be identified and corrected.

In Ontario, the wholesale electricity market benefits from a comprehensive approach to overseeing the proper functioning of the market. The IMO actively promotes market participant compliance with the rules, and supports the work of an independent Market Surveillance Panel to detect problems in the way the market operates and potential abuses by market participants.

Given the nature of electricity as a commodity, competitive wholesale electricity markets are complex, requiring a similarly complex set of rules and procedures. As a result, the IMO has taken a proactive role in ensuring that market participants are aware of and fulfill their obligations. We provide extensive market participant training, clarify issues of concern and offer advice.

With extensive expertise in economics, competition law and the energy sector, members of the IMO's Market Assessment and Compliance Division monitor and analyze market activity, looking for potential flaws in the design of the market and inappropriate market participant behaviour. This information is used to alert and sanction market participants who are not in compliance with the rules.

Experience in the first eight months of the open market has shown that, despite the steep learning curve market participants have had to follow, there have been relatively few instances of breaches and sanctions. And while there have been no apparent instances of gaming, the Market Assessment Unit identified the need to tighten the rules so that market participants are penalized when import or export transactions fail for reasons that are within their control.

THE MARKET SURVEILLANCE PANEL: AN INDEPENDENT VIEW

Led by York University's Financial Services Program Director Fred Gorbet, the Market Surveillance Panel is always on the lookout for better ways to run the Ontario wholesale electricity market. As an arm's-length body, accountable to the Independent Directors of the IMO Board, it provides an expert – and independent – view of the market. The Panel has already highlighted a number of areas for further development, particularly ways to enhance effective competition.

The three-member panel also investigates potential abuses of market power and gaming, or exploiting a loophole in the rules. While it does not possess the powers of a regulator, the Panel can make recommendations to the IMO, the Ontario Energy Board and the federal Competition Bureau for further action against any participant trying to manipulate the market to its advantage.

Ontario's approach to market compliance and surveillance is among the world's best, and will continue to improve with experience. As the Market Surveillance Panel noted in its report, the first months of market competition "have been a learning experience for all market participants, including the Panel. What is important is to build on what has been learned to make competition more effective."

IMO System Control Centre

PAULA LUKAN
Assistant Analyst – Market Assessment and Compliance Division

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IMO System Control Centre

LEADING THE WAY
MARKET

DEREK COWBOURNE
Vice President – Market Services

WHAT ARE THE NEXT STEPS?

Ontario's wholesale electricity market can't stand still. The experience of building and launching the market was only the first step in a much longer path that will lead to a more diverse market that offers greater flexibility and stability.

The IMO's Market Evolution Program is based on the principle that the best way to maintain reliability is to enhance the market. More efficient operations and transparent price signals in the market will strengthen the province's ability to balance the need for electricity with the supply of it. In addition, electricity markets throughout North America are evolving toward similar, and in some aspects standard, market designs, allowing greater harmonization and competition, while enhancing reliability.

The Market Advisory Council acts as the forum for discussion about the future shape of the market. The views of market participants and other interested groups are sought in setting priorities and understanding the impact of changes. These views will be incorporated in final decisions about future directions.

Market evolution involves change on a number of fronts. Maintaining reliability is the first and foremost concern, with efforts currently underway to ensure adequate supply for the summer of 2003 and over the long term. The IMO will be taking steps to shore up reliability over the summer months – particularly by encouraging large consumers to manage energy use during periods of high demand. Longer-term initiatives will explore new ways to promote investment in generation and increase price responsiveness.

Another important initiative under review is the development of a day-ahead market. Buyers in this market would purchase electricity a day in advance – based on their anticipated needs. The real-time market would then become a mechanism for market participants to adjust to higher or lower than expected demand. As a result, consumers would be better able to hedge their overall energy costs, fluctuations in the market would be significantly reduced, and reliability would be enhanced.

Environmental tracking – recording the amount of emissions generated by electricity sold in the wholesale market – is an objective set out for the IMO by the provincial government. The information provided by the tracking system will lead to an increased contribution of "green" resources to meet Ontario's electricity needs.

A vibrant, competitive market is one that constantly adapts and continually improves. The IMO will be leading the way to evolve the market, ensuring the long-term health of the electricity sector in Ontario.

Wind Turbine owned by
Toronto Hydro Energy Services
and WindShare

BRUCE CAMPBELL
Vice President – Corporate and Legal Affairs

"TO LEAD THE WAY IN EVOLVING THE MARKET, WE DEPEND ON THE TRUST OF MARKET PARTICIPANTS AND ALL ONTARIANS THAT WE WILL CONDUCT BUSINESS WITH INTEGRITY, PROFICIENCY AND THE HIGHEST DEGREE OF PROFESSIONALISM. WE INTEND TO MAINTAIN THAT TRUST BY CONTINUING TO DEMONSTRATE OUR CORPORATE VALUES AT WORK."

OUR VALUES, OUR PROMISE

The IMO is guided by our corporate values – *Respect, Integrity, Customer Focus, Performance, Capability* and *Adaptability*. These values help us meet our responsibilities to keep the lights on and protect the integrity of the market. They signify our commitment to exceed our customers' expectations.

Our values are put into action by a highly skilled and dedicated workforce, focused on excellence and committed to success. This means that we are accountable for our performance; we are proactive in meeting our customers' needs; and we act with consistency, objectivity and honesty. We embrace opportunities that will help us better fulfill our mandate.

With leadership comes a commitment to consult our partners about the choices we make. Moving forward to evolve the market requires that all market participants advance *together*. The IMO will act as a catalyst for change, working to ensure that these changes deliver benefits for all.

GARY SHERKEY
Vice President – Finance, CFO and Treasurer

"OVER THE PAST YEAR, IMO CONTINUED TO CONTROL COSTS WHILE MEETING THE NEEDS OF OUR CUSTOMERS. MOVING FORWARD, WE WILL MAINTAIN THIS COMMITMENT TO MANAGE OUR RESOURCES WISELY SO WE CAN PROVIDE HIGHLY EFFECTIVE PROGRAMS AND SERVICES THAT EVOLVE THE MARKET."

MANAGEMENT REPORT

Management's Responsibility for Financial Reporting

The accompanying financial statements of the Independent Electricity Market Operator are the responsibility of management and have been prepared in accordance with accounting principles generally accepted in Canada. The significant accounting policies followed by the Independent Electricity Market Operator are described in the Summary of Significant Accounting Policies contained in Note 2 in the financial statements. The preparation of financial statements necessarily involves the use of estimates based on management's judgement, particularly when transactions affecting the current accounting period cannot be finalized with certainty until future periods. The financial statements have been prepared within reasonable limits of materiality and in light of information available up to January 28, 2003.

Management maintained a system of internal controls designed to provide reasonable assurance that the assets were safeguarded and that reliable information was available on a timely basis. The system included formal policies and procedures and an organizational structure that provided for the appropriate delegation of authority and segregation of responsibilities.

These financial statements have been examined by PricewaterhouseCoopers LLP, a firm of independent external auditors appointed by the Board of Directors. The external auditors' responsibility is to express their opinion on whether the financial statements are fairly presented in accordance with generally accepted accounting principles in Canada. The Auditors' Report, which follows, outlines the scope of their examination and their opinion.

INDEPENDENT ELECTRICITY MARKET OPERATOR

On behalf of management,

Dave Goulding

DAVE GOULDING
President and Chief Executive Officer

Gary Sherkey

GARY SHERKEY
Vice President – Finance, CFO and Treasurer

Toronto, Canada
January 28, 2003

AUDITORS' REPORT

To the Board of Directors of the Independent Electricity Market Operator ("IMO")

We have audited the statement of financial position of the IMO as at December 31, 2002 and the statements of operations and accumulated surplus and cash flows for the year then ended. These financial statements are the responsibility of the IMO's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, the financial statements present fairly, in all material respects, the financial position of the IMO as at December 31, 2002, and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

PricewaterhouseCoopers LLP

Chartered Accountants
January 28, 2003

STATEMENT OF OPERATIONS AND ACCUMULATED SURPLUS

(in thousands of Canadian dollars)	FOR THE YEAR ENDED DECEMBER 31, 2002	FOR THE YEAR ENDED DECEMBER 31, 2001
REVENUES (Note 2(b))		
System fees	$ 146,650	$ 120,300
Other revenue	2,734	938
Ancillary services, rural rate assistance and remote subsidies	83,436	250,104
TOTAL REVENUES	**$ 232,820**	**$ 371,342**
EXPENSES		
Cost of ancillary services, rural rate assistance and remote subsidies	83,436	250,104
Labour	51,071	43,075
Transition costs	1,901	6,956
Computer services and support	11,038	14,044
Telecommunications	7,430	7,631
Other costs	11,129	10,817
Amortization	46,216	25,982
TOTAL EXPENSES	**$ 212,221**	**$ 358,609**
Net Income Before Interest	**20,599**	**12,733**
Interest income	2,737	3,072
Interest expense	(22,225)	(14,757)
NET INCOME FOR THE YEAR	**1,111**	**1,048**
ACCUMULATED SURPLUS – BEGINNING OF YEAR	9,604	8,556
ACCUMULATED SURPLUS – END OF YEAR	**$ 10,715**	**$ 9,604**

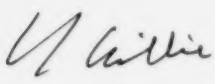
See accompanying notes to Financial Statements.

STATEMENT OF FINANCIAL POSITION

(in thousands of Canadian dollars)	AS AT DECEMBER 31, 2002	AS AT DECEMBER 31, 2001
ASSETS		
Current Assets		
Cash & cash equivalents	$ 47,818	$ 116,109
Amount due under Transitional Revenue Allocation Agreement	–	33,468
Temporary investments	65,158	–
Prepaid expenses & receivables	18,174	6,175
	131,150	**155,752**
Property & Equipment (Note 3)		
In service	237,001	251,072
Construction-in-progress	14,243	6,689
	251,244	**257,761**
Other Assets		
Prepaid pension expense (Note 6)	24,447	24,103
	24,447	**24,103**
TOTAL ASSETS	**$ 406,841**	**$ 437,616**
LIABILITIES		
Current Liabilities		
Accounts payable & accrued liabilities (Note 4)	$ 15,775	$ 49,421
Accrued interest	3,749	3,702
Long-term debt payable within one year (Note 5)	275,000	–
	294,524	53,123
Long-term Debt (Note 5)	78,200	353,200
Accrual for Employee Future Benefits Other than Pensions (Note 6)	23,402	21,689
TOTAL LIABILITIES	**396,126**	**428,012**
ACCUMULATED SURPLUS	**10,715**	**9,604**
TOTAL LIABILITIES & ACCUMULATED SURPLUS	**$ 406,841**	**$ 437,616**

See accompanying notes to Financial Statements.

On behalf of the Board:



JAMES C. BAILLIE

BARRY E. CHUDDY

STATEMENT OF CASH FLOWS

(in thousands of Canadian dollars)	FOR THE YEAR ENDED DECEMBER 31, 2002	FOR THE YEAR ENDED DECEMBER 31, 2001
OPERATING ACTIVITIES		
Net income for the year	$ 1,111	$ 1,048
Adjustments for non-cash items:		
Amortization	46,216	25,982
Increase in prepaid pension expense	(344)	(2,780)
Increase in accrual for employee future benefits other than pensions	1,713	2,556
	48,696	26,806
Changes in non-cash balances related to operations:		
Increase/(Decrease) in accounts payable and accrued liabilities	(3,406)	3,130
(Increase)/Decrease in prepaid expenses and receivables	(11,999)	1,018
(Increase)/Decrease in amounts due under Transitional Revenue Allocation Agreement	12,626	(4,316)
	(2,779)	(168)
Cash provided from operations	**$ 45,917**	**$ 26,638**
INVESTING ACTIVITIES		
Net purchase of temporary investments	(65,158)	–
Investment in property & equipment	(49,050)	(57,817)
Cash used in investing	**$ (114,208)**	**$ (57,817)**
FINANCING ACTIVITIES		
Issue of long-term debt	–	41,666
Cash provided from financing	**–**	**$ 41,666**
NET CHANGE IN CASH & CASH EQUIVALENTS	(68,291)	10,487
CASH & CASH EQUIVALENTS – BEGINNING OF YEAR	116,109	105,622
CASH & CASH EQUIVALENTS – END OF YEAR	**$ 47,818**	**$ 116,109**

See accompanying notes to Financial Statements.

Supplementary Information: *(in thousands of Canadian dollars)*		
Interest Paid	**$ 23,291**	**$ 21,454**

NOTES TO FINANCIAL STATEMENTS

1. NATURE OF OPERATIONS

Independent Electricity Market Operator (IMO) is a not-for-profit, non-taxable corporation, created by statute effective on April 1, 1999 pursuant to Part II of the *Electricity Act, 1998*. As set out in the *Electricity Act*, the IMO operates pursuant to a license granted by the Ontario Energy Board. The objects of the IMO as contained in the *Electricity Act*, are as follows:

- to exercise and perform the powers and duties assigned to the IMO under the *Electricity Act, 1998*, the market rules and license;
- to enter into agreements with transmitters giving the IMO the authority to direct the operations of their transmission systems;
- to direct the operations and maintain the reliability of the IMO-controlled grid to promote the purposes of the *Electricity Act, 1998*;
- to establish and operate the IMO-administered markets to promote the purposes of the *Electricity Act, 1998*;
- to collect and provide to the public information relating to the current and future electricity needs of Ontario and the capacity of the integrated power system to meet those needs;
- to participate in the development by any standards authority of standards and criteria relating to the reliability of the transmission systems;
- to work with the responsible authorities outside Ontario to co-ordinate the IMO's activities with their activities.

The North American electrical utility industry has undertaken initiatives to move away from traditional monopolies toward introducing competition into power generation. On October 30, 1998 the Government of Ontario enacted the *Energy Competition Act, 1998* to restructure the business carried on by Ontario Hydro and introduce competition. On May 1, 2002 the Government of Ontario opened the competitive electricity market.

On December 9, 2002 the Government passed Bill 210, *Electricity Pricing, Conservation and Supply Act, 2002*. Bill 210, among other things, freezes the commodity cost of electricity for a portion of the competitive market, specifically low-volume and designated customers, until May 1, 2006. The price signals for the wholesale price of energy continue to be set in the market, utilizing methodologies and systems unchanged from those utilized prior to Bill 210. In addition, currently customers that are neither low-volume or designated customers continue to pay market prices, unchanged from prior to the passage of Bill 210.

The *Electricity Act*, specifically Section 19, requires on an annual basis, that the IMO submit its proposed expenditures, revenue requirements, and fees it proposes to charge during the coming year to the Ontario Energy Board (OEB) for review. Bill 210 amended Section 19 to provide that the submission may be made only with the approval of the Minister of Energy, and that the fees approved for the 2002 fiscal year shall apply to the fiscal 2003 year. As specified in the *Electricity Act*, any surplus generated shall be used by the IMO for the purposes of carrying out its objects under the *Electricity Act*. The IMO expects to recover any deficit in future system fees, subject to approval by the Ontario Energy Board.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a) Basis of financial statement preparation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in Canada.

b) Revenue recognition

In accordance with an agreement between the IMO and the other successor entities of Ontario Hydro, the IMO received system fees and ancillary service fees during the period up to market opening on May 1, 2002. Such fees were approved by the Ontario Energy Board (OEB) and were recognized as earned in accordance with the terms of the agreement.

Since opening of the IMO-administered markets on May 1, 2002, system fees earned by the IMO are based on approved rates for each megawatt of electricity withdrawn from the IMO-controlled grid. System fees are recognized as revenue at the same time as the electricity is withdrawn.

Since market opening, ancillary service transactions became those of the market participants rather than the IMO. These financial statements do not include the financial transactions of market participants within the IMO-administered markets.

c) Transition costs and construction-in-progress

The IMO plays a key role in conjunction with market participants and other stakeholders in the development of the wholesale competitive electricity market in Ontario. As part of this role, the IMO is charged with developing and implementing the systems, including hardware and software, processes and procedures required to operate the competitive marketplace.

Costs relating to this initiative are capitalized to construction-in-progress, based on the expected future benefit, or charged to current operations as transition costs. Capitalized costs generally relate to the costs of physical facilities, hardware and software required for the operation of the market and include costs paid to vendors, internal and external labour, consultants, an applicable share of overhead, and an allocation of interest related to funds borrowed to finance the project. Costs relating to construction-in-progress are transferred to property and equipment in service when the asset under construction is deemed to be ready for use. Transition costs generally relate to the design of market rules, market and internal processes and procedures, and training and include costs for internal and external labour, consultants, and an applicable share of overhead.

d) Property and equipment in service

Property and equipment are capitalized at cost, which comprises materials, labour, external support, overheads, and interest applicable to capital activities.

e) Amortization
The capital cost of property and equipment in service is amortized on a straight line basis over their estimated service lives.

The estimated service lives in years, from the date the assets were transferred from Ontario Hydro or subsequently acquired, are:

Class	Estimated Average Service Life
Facilities	41
Data Acquisition and Computer Systems	4
Market Systems and Applications	4 to 7
Infrastructure and Other Assets	4 to 10

Gains and losses on sales of property and equipment and losses on premature retirements are charged to operations as adjustments to amortization expense. Removal costs are charged to amortization expense as incurred.

The estimated service lives of property and equipment and the significant assumptions underlying the estimates of removal costs are subject to periodic review. The impacts of changes in the estimated lives of property and equipment are amortized on a prospective basis. The most recent review was completed in fiscal 2002.

f) Cash and cash equivalents
Cash and cash equivalents comprise cash, term deposits and other short-term investments with original maturity dates of less than 90 days.

g) Temporary investments
Short-term money market investments with original maturities of 90 days or longer are classified as temporary investments and valued at amortized cost. Premiums and discounts are amortized to income using the constant yield method over the period to maturity.

h) Pension and other post-employment benefits
The IMO's post-employment benefit programs include pension, group life insurance, health care, long-term disability and workers compensation benefits.

The IMO accrues obligations under pension and other post-employment benefit ("OPEB") plans and the related costs, net of plan assets. Pension fund assets are valued using market related values for equities, whereby fund assets are calculated using a five-year moving average of year-end market values, and market values for fixed income securities. Pension and OPEB expenses and obligations are determined annually by independent actuaries using the projected benefit method and management's best estimates using a measurement date of September 30.

Pension and OPEB expenses consist of current service costs, interest and adjustments arising from plan amendments, changes in assumptions, and experience gains or losses, which are amortized on a straight line basis over the expected average remaining service life of the employees covered by the plan. Pension and OPEB expenses are recorded during the year in which employees render services.

i) Fair value of financial instruments
The carrying amounts reported in the balance sheet for financial instruments, comprising current assets and current liabilities approximate to their fair values. The fair value of the long-term debt is not readily available.

j) Foreign exchange
Transactions denominated in foreign currencies are translated into Canadian dollars at the rate of exchange prevailing on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated in Canadian dollars at the rate prevailing at that date. Exchange gains and losses arising on settlement of foreign exchange transactions are reported in the statement of operations at the date at which the transactions are settled.

k) Use of estimates
The preparation of the financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of revenues, expenses, assets and liabilities and the disclosure of contingent assets and liabilities as at the date of the financial statements. Actual results could differ from those estimates.

3. PROPERTY AND EQUIPMENT

	As at December 31, 2002			As at December 31, 2001
(in thousands of Canadian dollars)	Cost	Accumulated Amortization	Net Book Value	Net Book Value
Property and equipment in service				
Facilities	$ 48,147	$ 3,991	$ 44,156	$ 38,689
Data Acquisition and Computer Systems	26,515	26,515	–	7,017
Market Systems and Applications	183,733	38,310	145,423	152,043
Infrastructure and Other Assets	67,189	19,767	47,422	53,323
	325,584	88,583	237,001	251,072
Construction-in-progress	14,243	–	14,243	6,689
	$ 339,827	**$ 88,583**	**$ 251,244**	**$ 257,761**

Interest capitalized to construction-in-progress during 2002 was $960,331 (2001 – $5,591,124).

4. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

(in thousands of Canadian dollars)	As at December 31, 2002	As at December 31, 2001
Relating to Transitional Revenue Allocation Agreement	$ –	$ 20,842
Relating to property and equipment	2,178	11,529
Relating to operations	13,597	17,050
	$ 15,775	**$ 49,421**

5. LONG-TERM DEBT

(in thousands of Canadian dollars)	As at December 31, 2002	As at December 31, 2001
Notes payable	$ 353,200	$ 353,200
Less payable within one year	(275,000)	–
	$ 78,200	**$ 353,200**
Notes payable to		
Ontario Electricity Financial Corporation (OEFC)	$ 78,200	$ 78,200
The Province of Ontario	275,000	275,000
	$ 353,200	**$ 353,200**

Note payable to OEFC
The long-term note payable to Ontario Electricity Finance Corporation (OEFC) is unsecured, bears interest at 7.9% per annum and is repayable in full on May 1, 2009. Interest accrues daily and is payable in arrears, in equal semi-annual payments on May 1 and November 1 of each year.

Note payable to the Province of Ontario
The long-term note payable to the Province of Ontario is unsecured, and bears interest at 6.24%. Interest accrues daily and is payable in arrears, in equal semi-annual payments on May 3 and November 3 of each year. The loan is repayable in full on November 3, 2003.

The loan agreement provides for an extension of the repayment date if on or before October 27, 2003, the IMO is unable to obtain a credit rating, or has obtained a credit rating below a specific level, to the earlier of March 31, 2005 or six months after which a credit rating is either received or revised to a specific level. The loan will bear interest during the period of extension equal to the floating Bankers Acceptance rate plus 50 basis points.

Credit facility
The IMO has an unsecured, committed, and extendible 364-day revolving credit facility agreement with a Canadian chartered bank, under which the bank will make available to the IMO an amount up to $20 million. As at December 31, 2002 and 2001 no balance was drawn on the credit facility. Advances under this facility are available in Canadian dollars by way of prime rate loans or relevant Bankers' Acceptance rates. Unused portions of this credit facility are subject to a commitment fee of 10 basis points per annum and a Stamping Fee of 30 basis points per annum upon acceptance of each Bankers' Acceptance.

The IMO also has an unsecured, committed, and extendible 364-day revolving credit facility agreement with a banking syndicate, under which the syndicate will make available to the IMO an amount up to $100 million. As at December 31, 2002 no balance was drawn on this credit facility. Advances under this facility are available in Canadian dollars by way of prime rate loans or relevant Bankers' Acceptance rates. Unused portions of this credit facility are subject to a commitment fee of 10 basis points per annum and a Stamping Fee of 30 basis points per annum upon acceptance of each Bankers' Acceptance. This facility will mainly be used to fund shortfalls in amounts owed to the IMO by Market Participants for payment to other Market Participants prior to their recovery under the provisions of the market rules.

Additionally, the IMO has an unsecured, committed, and extendible 364-day revolving credit facility agreement (the "Deferred Payment Plan") with a banking syndicate, under which the syndicate would make available to the IMO on behalf of Market Participants who were subscribers to the Deferred Payment Plan, an amount up to $85,513,000. As at December 31, 2002 no balance was drawn on this credit facility. This facility was terminated on January 14, 2003.

6. BENEFIT PLANS

The IMO provides pension and other employee future benefits, comprising group life insurance, long-term disability and group medical and dental plans, for the benefit of current and retired employees.

Pension plans
From April 1, 1999 to December 31, 1999, the IMO participated in the OEFC Pension Plan, a contributory defined benefit, registered pension plan formerly known as the Pension and Insurance Fund of Ontario Hydro. As part of the restructuring of the electricity industry in Ontario, the assets, liabilities and a share of the OEFC Pension Plan's surplus were notionally allocated to each of the successor entities of Ontario Hydro on April 1, 1999.

The Independent Electricity Market Operator Pension Plan (the Plan) commenced on December 31, 1999 and assumed the IMO's share of the pension liabilities of the OEFC Pension Plan on January 1, 2000. The Plan received assets from the OEFC Pension Plan on July 3, 2001.

In addition to the funded, registered, pension plan, the IMO provides certain non-registered defined benefit pensions through an unfunded, non-registered plan.

Other employee future benefits
The group life insurance, long-term disability and group medical and dental benefits are provided through unfunded, non-registered defined benefit plans.

Summary of accrued benefit obligations and plan assets

(in thousands of Canadian dollars)	2002 Pension Benefits	2001 Pension Benefits	2002 Other Benefits	2001 Other Benefits
Accrued benefit obligation	$ 234,967	$ 193,401	$ 28,876	$ 25,863
Fair value of plan assets	203,693	216,499	–	–
Funded status	$ (31,274)	$ 23,098	$ (28,876)	$ (25,863)
Prepaid (accrued) benefit cost recognized in the statements of financial position	$ 24,447	$ 24,103	$ (23,402)	$ (21,689)

Summary of principal assumptions used to calculate benefit costs and obligations

	2002 Pension Benefits	2001 Pension Benefits	2002 Other Benefits	2001 Other Benefits
Discount rate	6.6% - 7.25%	7.0% - 7.25%	6.6% - 7.25%	7.0% - 7.25%
Expected return on plan assets	7.25%	7.25%	–	–
Rate of compensation increase	3.5%	3.5%	3.5%	3.5%
Rate of benefit increases	3.0%	2.5% - 3.0%	–	–
Expected average remaining service life of employees	12 years	12 years	12 years	12 years

Hospital and drug costs are assumed to increase by 8.0% in 2003, 7.0% in 2004, 6.0% in 2005, and by 5.0% per annum thereafter. Dental costs are assumed to increase by 5.0% per annum.

Summary of benefit costs and plan contributions

(in thousands of Canadian dollars)	2002 Pension Benefits	2001 Pension Benefits	2002 Other Benefits	2001 Other Benefits
Benefit cost (income)	$ (209)	$ (2,759)	$ 2,639	$ 2,604
Employer contributions	39	14	890	749
Plan participants' contributions	1,654	1,422	–	–
Benefits paid	7,833	7,049	890	795

7. SEGMENTED INFORMATION

The IMO consists of a single business engaged in the operation of the wholesale electricity system in Ontario.

8. COMMITMENTS

Operating commitments
The obligations of the IMO with respect to non-cancellable operating leases over the next five years is as follows:

(in thousands of Canadian dollars)	
2003	$ 1,851
2004	1,549
2005	893
2006	800
2007	841

Capital commitments
As at December 31, 2002, the IMO had non-cancellable capital commitments of $7,710,000.

9. COMPARATIVE FIGURES

Certain of the 2001 comparative figures in the financial statements have been reclassified to conform to the 2002 financial statement presentation.

BOARD OF DIRECTORS OF THE INDEPENDENT ELECTRICITY MARKET OPERATOR

Back row (L-r): Peter Budd, Ed Houghton, Robert McGavin, Carl Anderson, Barry Chuddy, Bruce Boland, Dale Struthers, Peter Jones, Bill Taylor.
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